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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JAMES FRANCIS O'HARA, III
MICHAEL PATRICK O'HARA,
INDIVIDUALLY AND AS GUARDIANS OF THE PROPERTY OF
JOSEPHINE M. O'HARA,

Petitioners,

v.

IRVIN KOVENS,
MARVIN MANDEL,
W. DALE HESS,
HARRY W. RODGERS, III, WILLIAM A. RODGERS,
ERNEST N. CORY, JR.,
EUGENE B. CASEY,
IRVING T. SCHWARTZ,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

The first question presented for review is whether the United States District Court for the District of Maryland erred in dismissing this securities fraud case on the basis of limitations. In particular, did the district court err in borrowing the one year period of limitations associated with the Maryland blue sky law rather than the three year period of limitations associated with common law fraud where:

(a) This Court held, in *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976), that an action under § 10(b) of the Securities Exchange Act of 1934 requires an intent to defraud;

(b) The Maryland blue sky law, unlike § 10(b) or the Maryland common law tort of fraud, does not require an intent to defraud; and

(c) The Maryland blue sky law did not even grant a private remedy to individuals situated as the O'Haras were here, that is, to defrauded *sellers* of securities, as of November 24, 1975, the earliest date upon which the O'Haras' cause of action may be deemed to have accrued?

The second question presented for review is whether the district court erred in determining that any statute of limitations whatsoever ran against Josephine M. O'Hara, who at all times on and after November 24, 1975, the earliest date upon which a cause of action may be deemed to have accrued in her favor, was totally mentally incompetent.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

James Francis O'Hara, III and Michael Patrick O'Hara, individually and as guardians of the property of Josephine M. O'Hara, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in this case on July 16, 1980.

OPINIONS BELOW

The opinion of the district court is reported at 473 F. Supp. 1161 (D. Md. 1979).

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at 625 F.2d 15 (4th Cir. 1980).

JURISDICTION

An opinion and order dismissing the O'Haras' complaint in this matter was handed down by the United States District Court for the District of Maryland (Joseph H. Young, J.) on July 12, 1979. A judgment of dismissal thereon was entered on July 16, 1979. On August 15, 1979 the district court denied petitioners' motion to vacate the judgment of dismissal and for reconsideration and revision of the rulings upon which the judgment was based.

On July 16, 1980 the United States Court of Appeals for the Fourth Circuit affirmed the judgment below. No rehearing was requested nor was an extension of time within which to petition for certiorari sought.

The jurisdiction of this Court is invoked under 28 U.S. C. § 1254(1).

CONSTITUTIONAL PROVISIONS, TREATIES, STATUTES, ORDINANCES, AND REGULATIONS INVOLVED

This case involves the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.;* Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5; the Maryland Securities Act, MD. CODE ANN., Corp. and Asso. Art. § 11-703; the MD. CODE ANN., Cts. and Jud. Pro. Art. §§ 5-101, 5-201, and 5-203.

Pertinent portions are reproduced in appendix A.

STATEMENT OF THE CASE

James Francis O'Hara, III and Michael Patrick O'Hara, individually and as guardians of their mother Josephine

M. O'Hara, filed a complaint in the United States District Court for the District of Maryland on November 22, 1978. The O'Haras sought compensatory and punitive damages against Irvin Kovens, Marvin Mandel, and certain of their associates for injuries arising out of the sale of the O'Haras' stock in the Marlboro Race Track on December 31, 1971. The complaint contains three counts of fraud, grounded respectively on federal securities law, state securities laws, and state common law. The case is the civil analog of criminal proceedings that were commenced against all of the respondents in this matter except Eugene B. Casey and Irving T. Schwartz in the United States District Court for the District of Maryland. The defendants in the criminal matter were found guilty and their convictions were affirmed on appeal. *U.S. v. Mandel, et al.*, 591 F.2d 1347, *reh. en banc* 602 F.2d 653 (4th Cir. 1979), *cert. denied* ___ U.S. ___, 48 U.S.L.W. 3662 (1980). The O'Haras are some of the defrauded former owners of Marlboro Race Track stock, the victims of the swindle which lay at the core of the criminal proceedings.

The details of the conspiracy among Kovens, Mandel, and their associates are as follows:

In the spring of 1971 a bill was introduced into the Maryland House of Delegates for the permanent transfer of 18 racing days from Hagerstown Race Track to Marlboro Race Track. Such a transfer would greatly increase the value of Marlboro Race Track stock. On May 28, 1971 Marvin Mandel, then governor of Maryland, vetoed the bill in order to depress the value of the stock of Marlboro Race Track and deceive the O'Haras and other owners of the stock as to the price they could expect to obtain for the stock on the open market.

On or about June 1, 1971 Irving T. (Tubby) Schwartz purported to buy 15,000 shares of Marlboro Race Track, at $7.00 per share. On two subsequent occasions Schwartz

again purported to purchase 2,000 additional shares. On all of these occasions Schwartz acted to conceal the fact that he had no beneficial interest in the stock he purchased and that the true beneficial owner was Irvin Kovens.

Through the use of the name of Ernest N. Cory, Jr., individually and "as attorney", the conspirators concealed the fact that they were, during 1971, seeking to acquire the O'Haras' and the other stockholders' financial interests in Marlboro Race Track. In December 1971 they purchased the controlling interest in Marlboro Race Track in such a way as to conceal their true identities. Thereafter, Mandel and his associates also used the name of Schwartz to conceal the true beneficial ownership of the additional financial interests in Marlboro Race Track acquired from the O'Haras and other sellers on December 31, 1971.

The conspirators arranged for Eugene B. Casey falsely to represent himself, on and after January 1, 1972, as the "new owner" of Marlboro Race Track, with the intention of concealing the financial interests of Kovens and the other conspirators in the race track from the O'Haras, from members of the state legislature, from the Maryland Racing Commission, and from the public.

Having laid the groundwork by first depressing the value of Marlboro stock, then secretly acquiring it at the lower price, the conspirators culminated their scheme in early 1972.

On or about January 7, 1972, Casey wrote to each member of the General Assembly of Maryland, to induce the members of that body to override Governor Mandel's veto of House Bill 1128, thereby increasing the value of the stock of Marlboro Race Track by virtue of the 18 additional racing days.

The fulcrum upon which the conspiracy rested was this: Marvin Mandel, by virtue of his office as governor of the State of Maryland, would himself and through his agents act to induce the legislature to override his own veto of the transfer bill. As a result of Mandel's actions and the actions of his co-conspirators the legislature did indeed override the veto on January 12, 1972, thereby permanently transferring to Marlboro Race Track the 18 racing days which formerly had been run at Hagerstown Race Track, and thereby greatly increasing the value of the Marlboro stock owned by the conspirators.

During parts of 1972 and thereafter, the conspirators used the services of Ernest Cory to conceal that fact that Kovens, Hess, Harry Rodgers, and William Rodgers, had beneficial ownership interests in Marlboro Race Track. The conspirators also used the names of approximately seven of their friends and family members in such a way as to conceal the identities of the true beneficial owners of Marlboro Race Track.

As the crowning touch of the conspiracy, Marvin Mandel, as governor, and other conspirators, used their efforts to induce the General Assembly of Maryland to pass a race track consolidation bill which would further increase the value of the Marlboro Race Track stock.

This too was successful. In December 1972 the Marlboro Race Track was merged with Bowie Race Track, thereby further increasing the value of the Marlboro stock theretofore fraudulently acquired from the O'Haras and others.

It was not until November 24, 1975, when a federal grand jury handed down indictments against Marvin Mandel, Irvin Kovens, W. Dale Hess, Harry W. Rodgers III, William A. Rodgers, and Ernest N. Cory, Jr. that the O'Haras began to realize that an intricate fraud had been practiced upon them. They filed suit in November 1978,

demanding compensatory and punitive damages for the wrongs done to them by the Kovens and Mandel group.

Federal jurisdiction over the O'Haras' federal securities law claims was based upon Section 22 of the Securities Act of 1933 (15 U.S.C. § 77v) and upon Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa). Federal jurisdiction over the O'Haras' state securities law claims and their common law fraud claims was based on the doctrine of pendent jurisdiction.

It is significant that on November 24, 1975, the date of the indictments, Josephine M. O'Hara, who was a plaintiff below through her two guardians, was, and for some time previously had been, totally mentally incompetent. It is also significant that, on November 24, 1975, defrauded sellers such as the O'Haras had no right of action under the Maryland blue sky law.

The various motions filed against the complaint all asserted, in essence, that the federal securities law count was barred by limitations. Since federal law provides no limitations period for the implied right of action under § 10(b) of the 1934 Act, a federal court sitting in such an action will apply the most analogous state statute of limitations. *Holmberg v. Armbrecht,* 327 U.S. 392 (1946), *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976). The choice in Maryland is quite clearly between the one year period of limitations established under the Maryland Securities Act (MD. CODE ANN., Corp. and Assoc. Art. § 11-703), and the three year period of limitations applicable under the Maryland statute of limitations for fraud, (MD. CODE ANN., Cts. and Jud. Pro. Art. § 5-101).

Despite this Court's decision in *Ernst and Ernst v. Hochfelder,* the district court held that the Maryland blue sky law was more analogous to the federal securities action implied under § 10(b) of the 1934 act than Maryland

common law fraud. Accordingly, it imposed a one year statute of limitations on the plaintiffs' federal cause of action.

As to Josephine O'Hara, the district court held that her undisputed mental incompetence did not toll the running of the statute of limitations against her.

Accordingly, the district court dismissed the O'Haras' federal securities action on the ground of limitations. The district court further held that this deprived the federal court of pendent jurisdiction over the state securities count and the state common law fraud count. They were likewise dismissed.

Following oral argument, the United States Court of Appeals for the Fourth Circuit requested that the parties file supplemental briefs on certain questions: what the appropriate statute of limitations was on that date of accrual; whether the subsequent broadening of the Maryland blue sky law to confer a right of action upon defrauded sellers was intended to be and could in fact be retroactively applied; and whether state or federal law governed questions of accrual when a period of limitations was borrowed from state law for a federal statute.

On July 16, 1980 the court of appeals affirmed the dismissal, although for reasons different from those stated in the district court's opinion. Relying on its decision in *Fox v. Kane-Miller Corporation,* 542 F.2d 915 (4th Cir. 1976), a decision which did *not* consider this Court's holding in *Ernst & Ernst v. Hochfelder,* the court held that the one-year period of limitations under Maryland blue sky law was applicable to the O'Haras' cause of action. On the issue of the tolling effect of Mrs. O'Hara's mental incompetence, the court of appeals, unlike the district court, held that this was a matter governed by state law but that state law had no provision for tolling on the

grounds of incompetence which was applicable to Mrs. O'Hara.

REASONS FOR GRANTING THE WRIT

I.

REVIEW IS NECESSARY TO RESOLVE A CONFLICT BETWEEN FEDERAL CIRCUITS AND TO ESTABLISH UNIFORM GUIDELINES IN A VITAL AREA OF FEDERAL SECURITIES LAW.

The O'Haras' federal claims are based, in main part, on the so-called implied private right of action under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities Exchange Commission. Although neither the section nor the rule by its terms creates an express private remedy for its violation, the existence of an implied private right of action is now well established. See *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975).

Those sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 creating express civil remedies are governed bv an express statute of limitation (one year from the time the violation was or should have been discovered, but not longer than three years from the time of the offer or sale). It is settled law, however, that the limitations period governing these express civil remedies does not govern the right of action implied under Section 10(b) of the 1934 Act. In *Ernst & Ernst v. Hochfelder, supra*, this Court adverted to the rule directing federal courts to look to or "borrow" the law of limitations of the forum state, saying:

> Since no statute of limitation is provided for civil actions under § 10(b), the law of limitations of the forum State is followed as in other cases of judicially implied remedies. . . Although it is not always certain which state statute of limitations should be followed, such statutes of limitations are usually

> longer than the period provided [for the express civil remedies].

425 U.S. at 210 note 29 (citations omitted).

When this Court noted in *Ernst* that "it is not always certain which state statute of limitation should be followed", it understated, at least in retrospect, the magnitude of the problem. There is now a raging conflict among the federal circuits, a conflict of which this case is a part, as to which state statute of limitations must be borrowed. The issue is important because most states have at least two possible periods of limitation. Maryland is typical — there is a three year period (specified in MD. CODE ANN., Cts. and Jud. Pro. Art. § 5-101) which is applicable to actions for fraud or deceit, and there is a one year period (set forth in the MD. CODE ANN., Corp. and Assoc. Art. § 11-703) applicable to actions under the Maryland blue sky law.

Which period should be applied? Superficially, the choice is simple. When a federal court must "borrow" a state period of limitations to apply to a federal cause of action, the federal court is to select the state statute which (1) is substantively closest to the federal statute and (2) best effectuates the policies behind the federal statute. *International Union v. Hoosier Cardinal Corporation,* 383 U.S. 696 (1966). In reality, the difficulties inherent in this choice have plunged the circuits into a morass of inconsistent and irreconcilable decisions.

The Fourth Circuit, in the decision below and in other, pre-*Ernst* decisions, together with the Seventh Circuit,[1] the Eighth Circuit,[2] and the District of Columbia Circuit[3]

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[1] *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (7th Cir. 1972).

[2] *Vanderboom v. Sexton,* 422 F.2d 1233 (8th Cir. 1970).

[3] *Forrestal Village, Inc. v. Graham,* 551 F.2d 411 (D.C. Cir. 1977).

continue to take the position that the period of limitations governing a state's blue sky law, rather than that governing its common law fraud actions, is the period which should be borrowed. On the other hand, the First,[4] Second,[5] Sixth,[6] Ninth[7] and Tenth[8] circuits have almost uniformly applied the period of limitations governing state common law fraud actions rather than state securities law actions. The Fifth Circuit is in a state of flux, although its most recent pronouncement seems to be edging toward the O'Haras' point of view.[9, 13] The Third Circuit has recently joined the O'Haras' camp, at least in cases such as this where the state's blue sky law did not give defrauded *sellers* a right of action when the defrauded sellers' claim matured.[10]

These different results arise not from differences in state law but rather from inconsistent interpretations by different federal courts of the same body of federal law.

Certain circuits, including the one in which this case arises, have held that *Ernst* had little or no effect on borrowing statutes of limitations for federal securities laws. Others, such as the Court of Appeals for the Fifth

[4] With little discussion, the First Circuit has applied the Massachusetts statute of limitations governing actions based on tort, rather than the period of limitations governing actions under that state's securities act. *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978).

[5] *Stull v. Bayard*, 561 F.2d 429 (2nd Cir. 1977), *cert. denied* 434 U.S. 1035 (1977).

[6] *Nickels v. Koehler Management Corp.*, 541 F.2d 611 (6th Cir. 1976), *cert. denied*. 429 U.S. 1074 (1976).

[7] *United California Bank v. Salik*, 481 F.2d 1012, (9th Cir. 1973).

[8] *Mitchell v. Texas Gulf Sulphur Company* 446 F.2d 90 (10th Cir. 1971), *cert. denied* 404 U.S. 1004 (1971).

[9] *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888 (5th Cir. 1979), *rev'g*. 429 F. Supp. 359 (N.D. Ga. 1977).

[10] *Roberts v. Magnetic Metals Company*, 611 F.2d 450 (3rd Cir. 1979), *rev'g*. 463 F. Supp. 934 (D.N.J. 1978).

Circuit in *McNeal v. Paine, Webber, Jackson & Curtis Inc.*, 598 F.2d 888 (5th Cir. 1979) have held that *Ernst* necessitated a change in the federal law of borrowing. They cannot both be correct.

In the proceedings below, Messrs Kovens, Mandel, and their fellow conspirators had relied heavily upon the district court's opinion in *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 429 F. Supp. 359 (N.D. Ga. 1977). In reversing, the Fifth Circuit concluded ". . . the cause of action available under the general fraud statute more closely resembles McNeal's cause of action under section 10(b) than that available under the Georgia Securities Act of 1957. Therefore, the four-year statute of limitations applicable to actions under the fraud statute is applicable to the section 10(b) claim asserted here." *McNeal*, 598 F.2d at 894.

Significantly, and perhaps as a warning to the bar generally that it's pre-*Ernst Hudak* decision should no longer be relied upon, the Fifth Circuit said: "to the extent that the result in *Hudak* (i.e., reference to Florida's securities law rather to its general fraud law) depends on the relaxed scienter requirement, *that result has been undermined by Hochfelder.*" *McNeal*, 598 F.2d at 895 note 18 (emphasis supplied).

In *Roberts v. Magnetic Metals Company*, 611 F.2d 450 (3rd Cir. 1979), *rev'g.* 463 F. Supp. 934 (D.N.J. 1978), yet another decision relied upon below was reversed. The circuit court's opinion, written by Judge Gibbons, adopts *in toto* the O'Haras' theory of borrowing the state common law fraud limitations period. The case is also significant, however, because it deals with another aspect of the controversy of which this case is a part.

The *Roberts* case dealt with a defrauded seller, who had no right of action under the New Jersey blue sky law. Both

the majority opinion and the concurring opinion by Judge Sloviter emphasize the significance of this fact. In essence, both opinions reason that a state statute (New Jersey blue sky law) under which the injured party had *no* right of action could not, under any reasonable construction, be deemed more analogous to a federal securities fraud action than a state action (common law fraud) under which the injured party *might* have sued.[11]

There is no dispute that, at the time their cause of action may be deemed to have accrued, the O'Haras, like the plaintiffs in *Roberts*, had *no* right of action as defrauded sellers under the Maryland blue sky law. This point was stressed below, but the court of appeals found it to be without significance. This follows the pattern that the Fourth Circuit had adopted in *Fox v. Kane-Miller Corp.*, 542 F.2d 915 (4th Cir. 1976), a decision that court expressly reaffirmed below.

Commenting on this very point, the *Roberts* court found the *Fox* reasoning "unpersuasive, if for no other reason than its failure even to make note of the fact that the statute relied upon did not provide a cause of action for any one other than a buyer." 611 F.2d at 455.[12]

[11] Judge Gibbons discussed the point thus:

> ". . . since the New Jersey Uniform Securities Act is wholly inapplicable to the transaction alleged in the Complaint, the analogy escapes us. Indeed, because the facts alleged in the Complaint are actionable under both the 1934 Act and under New Jersey common law the closest analogy is the one rejected by the District Court.

611 F.2d at 454.

[12] It seems likely that the District of Columbia Circuit would go along with the Third Circuit and the O'Haras on this point. In *Forrestal Village, Inc., v. Graham,* 551 F.2d 441 (D.C. Cir. 1977), the court stated:

> Admittedly, there are some differences between the relevant federal and local statutes. Under Section 10(b) both buyers and sellers have a claim, whereas the D.C. Act provides a cause of action to buyers only. Because the

Some courts, such as the court below, have held that long statutes of limitation are not favored in federal securities law. Others, such as the Sixth Circuit in *Nickels v. Koehler Management Corporation,* 541 F.2d 611 (6th Cir. 1976), *cert. denied* 429 U.S. 1074 (1976), have held that the broad remedial purposes of the federal securities laws are best served by a longer — *not* a shorter — statute of limitations. These decisions deal with an important policy aspect of federal securities law, an aspect clearly implicated in the instant case. Yet they, like a number of the cases just discussed, cannot be reconciled.

This Court in *Ernst & Ernst v. Hochfelder* undertook a fundamental re-examination of the implied private right of action under section 10(b) of the 1934 Act. This re-appraisal led the Court to the conclusion that scienter is a crucial element of a violation of that law. The holding in *Ernst* must be a paramount element of any attempt by a lower federal court to draw analogies between § 10(b) and similar causes of action under state law.

Many courts have taken *Ernst* to heart and have used it as the basis for determining which state statute is the most analogous for borrowing purposes. These courts have adopted the limitations period of common law fraud, rather than the limitations period of state securities law.[13]

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instant case is a suit by a buyer, however, this difference is not material.

551 F.2d at 414.

The negative implication is strong that had the suit been brought by a defrauded seller (such as the O'Haras) the difference between the federal and local statutes *would* have been material.

[13] The district court below relied in its opinion on *Vanderboom v. Sexton,* 422 F.2d 1233 (8th Cir. 1970). Interestingly, in *Posner v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.,* 469 F. Supp. 972 (S.D.N.Y. 1979), Judge Haight, applying Arkansas and Eighth Circuit law, found that *Ernst* compelled a reassessment of the *Vanderboom* decision and had undermined its *ratio decidendi:* "With the requirement of scienter the . . . action

Other jurisdictions have relied upon superfical similarities in wording and a perceived commonality of purpose, ignoring or specifically rejecting the rationale of *Ernst,* and have held that state blue sky laws are most analogous for borrowing purposes. Only this Court can say which approach is correct and can put an end to the present conflict between jurisdictions.

As Judge McCree, former circuit judge and now the Solicitor General of the United States, said in *Nickels v. Koehler Management Corporation, supra:*

> Although a uniform federal period of limitations would prevent the anomaly of applying different limitations periods to plaintiffs who purchased or sold the same security but resided in different states a single circuit cannot impose a pattern on the entire nation. Each circuit that has considered the question to date has applied a state period of limitation. Accordingly, at this late hour only Congress or the Supreme Court can impose uniformity. Neither has promulgated a federal limitation period, and the Supreme Court recently observed that "since no statute of limitations is provided under § 10(b), the law of the forum state is followed as in other cases of judicially implied remedies." [Citation omitted]

541 F.2d at 614.

most closely analogous to actions brought under Rule 10b-5 is that for common law fraud." 469 F. Supp. at 982.

Another decision relied upon by the district court below, *Hudak v. Economic Research Analysts, Inc.,* 499 F.2d 996 (5th Cir. 1975) was recently pronounced to be "of dubious authority" in *First Federal Savings and Loan Association of Miami v. Mortgage Corporation of the South,* 467 F. Supp. 943 (N.D. Ala. 1979).

> "The Supreme Court has put this matter to rest in *Ernst* . . . . There the court expressly held that Rule 10b-5 incorporates a scienter requirement — an intent to deceive, manipulate or defraud. Negligence as a ground for recovery was rejected. The *Hudak* court's choice of a statute of limitations was based on . . . reasoning which has been rejected by the Supreme Court. It must appear then that *Hudak* may be dubious authority."

467 F. Supp. 952.

Judge Gibbons agrees: "Much can be said, perhaps, for a different rule [than borrowing] in a different context directing a Federal court to statutes of limitations governing analogous Federal causes of action. But the rule has been otherwise for many years, and an inferior federal court is not free to change it." *Roberts v. Magnetic Metals Co., supra,* 611 F.2d at 454.

Since borrowing is the rule, it is imperative that this Court clarify the standards to be applied and end the confusion that has arisen in the wake of the decision in *Ernst.*

II.

THIS CASE INVOKES TWO STRONG REMEDIAL PURPOSES — THOSE OF FEDERAL SECURITIES LAW AND THOSE PROTECTING MENTAL INCOMPETENTS. NEITHER OF THESE PURPOSES WAS ADEQUATELY SERVED BY THE COURTS BELOW.

The district court held that the matter of tolling the statute of limitations by reason of Mrs. O'Hara's mental incompetency was clearly governed by state law. The court of appeals in effect overruled the lower court but reached the same result on different grounds. Specifically, the court of appeals was guided, perhaps properly so far as it went, by *Johnson v. Railway Express Agency, Inc.,* 421 bu.S. 454 (1975). Both *Johnson* and the recent case of *Board of Regents v. Tomiano,* ___ U.S. ___, 48 U.S.L.W. 4556 (May 19, 1980) show that where state law is borrowed for a limitations period, state law should also furnish the ground to be searched for tolling and other ancillary provisions of limitations. The perfunctory, mechanistic approach taken by the courts below is not only at odds with the clear teaching of *Johnson* but clearly thwarts the remedial purposes of the federal securities law.

As this Court stated in *Johnson:*

> Although state law is our primary guide in this area, it is not, to be sure, our exclusive guide. As the court noted in *Auto Workers v. Hoosier Corp.* . . . [citation omitted] . . . considerations of state law may be displaced where their application would be inconsistent with the federal policy underlying the cause of action under consideration.

421 U.S. at 464-465.

As was more strongly stated by Chief Judge Lord in *Eubanks v. Clarke,* 434 F. Supp. 1022 (E.D. Pa. 1977):

> We glean from *Burnett, Hoosier Cardinal Corp., Holmberg,* and *Moviecolor Limited* that federal courts should utilize equitable principles and fashion their own tolling provisions in those infrequent situations where state statutes of limitations effectively deny rights or impede policies created by federal law . . . .
>
> Where a federal cause of action may effectively be defeated, a federal court may have the duty to fashion a tolling provision.

434 F. Supp. at 1031 and 1032.

The remedial purposes of federal securities regulation are too well known to require restating. Equally clear is the paternalistic and protective policy of the state of Maryland towards mental incompetents. It manifests itself in at least three respects: (1) limitations do not begin to run against a mental incompetent until the disability is removed (something which will never happen in Josephine O'Hara's case);[14] (2) Maryland follows the "discovery rule" in dealing with ignorance of a cause of action induced by fraud, and provides that the cause of action "accrues"

[14] Courts and Judicial Proceedings Article § 5-201(a) states: "When aon subject to a limitation under Sub-title 1 *accrues* in favor of a minor or mental incompetent, that person shall file his action within the lesser of three years or the applicable period of limitations after the date the disability is removed. (emphasis supplied).

when the party discovers or by the exercise of ordinary diligence should have discovered the fraud;[15] and (3) the Court of Appeals of Maryland has repeatedly held that even the appointment of a guardian for the mental incompetent will not commence or resume the running of the period of limitations. *Funk v. Wingert,* 134 Md. 523 (1919); *McBride v. Gulbro,* 247 Md. 747 (1967); and *Mullins v. Thorne,* 254 Md. 434 (1969).[16]

Under even the most basic reading of *Johnson,* the policies of the State of Maryland with regard to mental incompetents must be incorporated into federal law along with the gross computational aspects of any Maryland period of limitations. A close reading of *Johnson* and such cases as *Eubanks v. Clarke, supra,* shows that even if Maryland policies were not as clear as they are, a federal court would have an affirmative duty to fashion its own tolling provisions. The alternative constitutes an effective denial of an important federal rights to mental incompetents, a class of individuals particularly in need of protection.

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[15] Court and Judicial Proceedings Article § 5-203 deals with ignorance of a cause of action induced by fraud and provides:

> If a party is kept in ignorance of a cause of action by the fraud of an adverse party, the cause of action shall be deemed to *accrue* at the time when the party discovered, or by the exercise of ordinary diligence should have discovered the fraud. (emphasis supplied).

[16] In this context, the opinion in *McDonald v. Boslow,* 363 F. Supp. 493 (D. Md. 1973) is worth noting. There, the district court found that the three year general limitation period of the Maryland code also governed actions under 42 U.S.C. § 1983. The court dealt at length with the plaintiff's contention that the limitations period "has even today not yet begin to run against him in connection with any wrongs alleged by him in this case" because, as a "defective delinquent", he was within the ambit of the exception provided for mental incompetence. The Court ultimately found that a defective delinquent was *not* a mental incompetent within the meaning of the statute. However, the tenor of the opinion clearly indicates had the plaintiff been found *non compos mentis,* such disability would have tolled limitations for the federal cause of action.

The courts below charged an admitted mental incompetent with the affirmative burden of discovering a highly sophisticated and virtually unique fraud scheme within a very brief period of time. The court of appeals, in particular, seized upon what common sense can only view as an oversight in drafting (or a drafting decision that no reiteration was necessary) — the fact that the general provision which provides for tolling under Maryland law was not expressly made applicable to the special provisions of Maryland securities law.

In effect, the court of appeals declined to extend tolling protection to Mrs. O'Hara because the court was unable to find a provision in Maryland law which *compelled* it to do so. This goes against both the teaching and the sense of the law and thwarts important federal and state policies.

III.

THE DECISION BELOW IS ERRONEOUS IN THE LIGHT OF THIS COURT'S DECISION IN *ERNST*.

The Court in *Ernst* converted § 10(b) of the Securities Exchange Act of 1934 from a negligence-and-fraud statute into a fraud-only statute. This change is so fundamental that it is virtually dispositive of the search for an analogous state law. The choices are the Maryland Securities Act, which is a negligence-and-fraud statute, and the common law tort of fraud and deceit, which embraces only fraudulent conduct. After *Ernst,* the state analog to a § 10(b) action is common law fraud. It is not the blue sky law of Maryland or of any other state which allows actions thereunder to be predicated on negligence.

The fact that Maryland blue sky law did not even grant a private remedy to defrauded sellers such as the O'Haras at the time their cause of action accrued furnishes a separate, independent reason for this result.

For these reasons, recognized and applied by the First, Second, Third, Fifth, Sixth, Ninth, and Tenth circuits, the lower courts' decision in this case should be reversed.

Petitioners also believe that this Court in *Ernst* by clear implication rejected the application of a one-year period of limitations to actions under § 10(b) and Rule 10b-5. The Court was considering whether a cause of action under § 10(b) could be premised on negligent wrongdoing. A crucial point in the Court's analysis seemed clearly to be that actions under the 1933 Act, which could be premised on negligent wrongdoing, were subject to what the Court characterized as "significant procedural restrictions not applicable under § 10(b)". 425 U.S. at 209. The procedural restriction dealt with at most length by the Court was a one-year statute of limitations. The Court said nothing about any alleged federal preference for short limitations periods in securities actions. This is because there is no such federal policy. Rather, the Court indicated that a one-year statute of limitations, as an absolute matter, was too short to apply to an action under § 10(b) — an action which requires scienter. In a footnote to a sentence which summarized the significance of the absence of procedural restrictions such as a one-year statute of limitations in an action under § 10(b), the Court spoke to the borrowing issue:

> Since no statute of limitations is provided for civil actions under § 10(b), the law of limitations of the forum State is followed . . . Although it is not always certain which state statute of limitation should be followed, such statutes of limitations are usually longer than the period provided under § 13 [a one year period] 425 U.S. 210, fn. 29 (citations omitted)

The opinion in *Ernst,* against the background of the federal policies upon which it is based, justifies an out-of-hand rejection of the one-year limitations period as being too short to impose upon a cause of action under § 10(b).[17]

[17] The highly respected District Judge Edward Weinfeld, from the Southern District of New York, in a very recent decision, appears to agree with petitioners that the *Ernst* case (and specifically footnote 29) in and of itself compels the borrowing of a state period of limitations for actions based on common law fraud. In *Gilman Brother v. Peat, Marwick, Mitchell & Company,* 486 F. Supp. 785, 786 note 5, (S.D.N.Y. 1980) the court said:

> Federal law, in the absence of a limitation period in the securities statute upon which a plaintiff's claim is based, applies state statutes of limitations for actions based upon common law fraud. See *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 210 n. 29, 96 S. Ct. 1375, 1389 n. 10, 47 L. Ed. 2d 668 (1976); *Phillips v. Levie,* 593 F.2d 459, 462, (2d Cir. 1979); *Stull v. Bayard,* 561 F.2d 429, 431 (2d Cir. 1977), cert. denied, 434 U.S. 1035, 98 S. Ct. 769, 54 L. Ed. 2d 783 (1978); *Arneil v. Ramsey,* 550 F.2d 774, 779 (2d Cir. 1977). The stock purchase was consumated in Massachusetts, the state of plaintiff's residence.

CONCLUSION

As long as state statutes of limitations must be borrowed for federal securities actions, there can be no national uniformity as to the time period of limitations. There can and should, however, be uniformity as to the *generic type* of state limitations period to be borrowed and applied in federal securities actions. Only this Court can establish the standard which will bring about the desired consistency of results. Almost all federal circuits have now addressed the problem and the results are irreconcilable. The issue is ripe for resolution by this Court.

Whether limitations against a plaintiff in a federal securities action should be tolled where the plaintiff is mentally incompetent is a question which likewise implicates important federal policies, and it, too, is ripe for decision by this Court.

For these reasons, petitioners respectfully request that their petition for writ of certiorari be granted.

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October 10, 1980

APPENDIX

In The United States District Court
for the District of Maryland

Civil No. Y-78-2329

James Francis O'Hara, III, et al.

v.

Irvin Kovens, et al.

Filed: July 12, 1979

William A. Snyder, Jr., Esquire, Baltimore, Maryland, John T. Ward, Esquire, Baltimore, Maryland, and James B. Wieland, Esquire, Baltimore, Maryland, counsel for the plaintiffs.

William F. Gately, Esquire, Baltimore, Maryland, counsel for Irvin Kovens. Arnold M. Weiner, Esquire, Baltimore, Maryland, M. Albert Figinski, Esquire, Baltimore, Maryland, and Ira C. Cooke, Esquire, Baltimore, Maryland, counsel for Marvin Mandel. William G. Hundley, Esquire, Washington, D.C., counsel for W. Dale Hess. Thomas C. Green, Esquire, Washington, D.C., counsel for Harry W. Rodgers, III. H. Russell Smouse, Esquire, Baltimore, Maryland, counsel for Irving T. Schwartz. Gary M. Anderson, Esquire, Laurel, Maryland, counsel for Ernest N. Cory, Jr. Michael E. Marr, Esquire, Baltimore, Maryland, counsel for William A. Rodgers. Charles W. Bills, Esquire, Gaithersburg, Maryland, counsel for Eugene B. Casey.

YOUNG, United States District Judge

The plaintiffs, James, Michael, and Josephine M. O'Hara, seek compensatory and punitive damages against the defendants as the result of the sale of their stock in the Marlboro Race Track to the defendants on December 31, 1971. The complaint alleges three counts of fraud based upon state and federal law. Count I states a federal cause of action alleging that defendants' conduct violated Rule 10b-5,[1] 17 C.F.R. § 240.10b-5 (1978), promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, 15 U.S. C. § 78j (1976). Count II asserts a violation of the Maryland Securities Act, MD. CORP. & ASS'NS CODE ANN. § 11-101 *et seq.* Count III alleges that defendants' acts constituted common law fraud. Since Counts II and III are state causes of action, federal jurisdiction is asserted under the doctrine of pendent jurisdiction.

This lawsuit is based on facts developed when a federal grand jury handed down indictments on November 24, 1975 against former Maryland Governor Marvin Mandel and certain associates who were alleged to have engaged in certain illegal activities in connection with the stock of the Marlboro Race Track, now known as the Bowie Race Track. Plaintiffs claim that the defendants conspired to

[1] Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any mean or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

acquire the controlling interest in the Marlboro Race Track without disclosing their intentions to plaintiff shareholders, the Maryland legislature, the Maryland Racing Commission, and the general public.

The conspirators allegedly acted between January 7, 1969 and May 28, 1971 to depress the value of plaintiff's stock. This purported manipulation was supposedly accomplished by Governor Mandel's veto of House Bill 1128 which would have effectuated a permanent transfer of eighteen racing days from Hagerstown Race Track to Marlboro Race Track. After the veto, with the stock commanding a lower price, it is alleged the defendants began acquiring a controlling interest through several different routes.

Stock purchases continued throughout 1971, and one of the defendants, Eugene B. Casey, wrote to each member of the Maryland General Assembly on or about January 7, 1972 purportedly to induce the legislators to override the Mandel veto of House Bill 1128. Such an override would increase the value of Marlboro Race Track stock by virtue of alloting it the additional eighteen racing days. The legislature did in fact override the Governor's veto on January 12, 1972, and the plaintiffs maintain that Governor Mandel himself acted directly and through his agents with the intent to have his own veto overriden. The stock value was further boosted by passage of the 1972 race track consolidation bill which was supported by Governor Mandel and the other defendants.

Having become aware of the allegedly fraudulent practices engaged in by defendants, plaintiffs filed this suit on November 22, 1978, almost exactly three years after the first indictments were brought. They seek compensatory and punitive damages totaling $15,000 [$15,000,000] plus interest, costs, and fees as well as the appointment of a receiver for the Bowie Race Track stock and such additional relief as may be necessary.

At this juncture, defendants Kovens and William Rodgers have moved for judgment on the pleadings pursuant to Fed. R. Civ. Proc. Rule 12(c). Defendants Mandel, Hess, Harry Rodgers, Cory, and Schwartz have moved to dismiss for failure to state a cause of action upon which relief can be granted. Fed. R. Civ. Proc. Rule 12(b) (6). Defendant Casey has filed an Answer in which he prays for dismissal of the complaint. After reviewing the case and the legal memoranda filed therein, the Court will grant defendants' motions pursuant to Rule 12.

Defendants' motion to dismiss raises one straightforward legal issue, namely, whether the appropriate statute of limitations period for this 10b-5 action is the one-year period established by the Maryland Securities Act, MD. CORP. & ASS'NS CODE ANN. § 11-703(f) (2), or the three-year period applicable under the Maryland statute of limitations for fraud actions, MD. CTS. & JUD. PROC. CODE ANN. § 5-101.[2] Since there is no period of limitations prescribed in the statute for actions brought under section 10(b), courts have adopted the most "analogous" State statute of limitations. Once courts began implying civil remedies under rule 10b-5, *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), it might have been expected that they would have borrowed the limitations periods which accompany those sections of the Securities Act of 1933 or the Securities Exchange Act of 1934 which set forth their own express liability clauses and limitations periods.[3]

[2] Section 11-703(f) (2) provides that "[a] person may not sue under this section . . . one year after the discovery of the untrue statement or omission, or after the discovery should have been made by the exercise of reasonable diligence."

Section 5-101 provides that "[a] civil action at law shall be filed within three years from the date it accrues unless another provision of the Code provides a different period of time within which an action shall be commenced."

[3] In the 1933 Act, liability sections having their own limitations periods include sections 11, 12 and 15 which are governed by section 13. 15 U.S.C. §§ 77k, 77*l*, 77m and 77o. Sections 9(e), 18, and 29(b) of the 1934 Act, 15 U.S.C. §§ 78i(e), 78r, and 78cc, contain their own limitations periods.

Instead, courts followed the well-settled principle of *Holmberg v. Armbrecht,* 327 U.S. 392 (1946), that "the timeliness of an action under the federal securities laws is to be determined by reference to the appropriate State statute of limitations." *Fox v. Kane-Miller Corp.,* 542 F.2d 915, 917 (4th Cir. 1976). In *Holmberg,* Justice Frankfurter had explained that "[t]he implied absorption of State statutes of limitations within the interstices of the federal enactments is a phase of fashioning remedial details where Congress has not spoken but left matters for judicial determination within the general framework of familiar legal principles." 327 U.S. at 395.

The first cases to apply the *Holmberg* reasoning held that the controlling limitations provision was the State statute of limitations for fraud actions;[4] however, more recent cases have shown a trend toward adopting the statute of limitations in a State's Blue Sky Laws.[5] Two commentators have explained the effects of choosing one theory over the other:

> If the "fraud" statute of limitations is adopted, then it typically will not begin to run until "discovery" of the fraud. However, if the Blue Sky statute of limitations is applied and contains no such tolling provision the cases have uniformly held that the general Federal

[4]. *See, e.g., Errion v. Connell,* 236 F.2d 447 (9th Cir. 1956); *Fischman v. Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951); *Chiodo v. General Waterworks Corp.,* 380 F.2d 860 (10th Cir.) *cert. denied,* 389 U.S. 1004 (1967); *Azalea Meats, Inc. v. Muscat,* 386 F.2d (5th Cir. 1967); *Klein v. Auchincloss, Parker & Redpath,* 436 F.2d 339 (2d Cir. 1971); *Sackett v. Beaman,* 399 F.2d 884 (9th Cir. 1968).

[5] *See, e.g., Hudak v. Economic Research Analysts, Inc.,* 499 F.2d 996 (5th Cir.), *cert. denied,* 419 U.S. 1122 (1974); *Parrent v. Midwest Rug Mills, Inc.,* 455 F.2d 123 (7th Cir. 1972); *Vanderboom v. Sexton,* 422 F.2d 1233 (8th Cir.), *cert. denied,* 400 U.S. 852 (1970); *Nickels v. Koehler Management Corp.,* 392 F. Supp. 804 (N.D. Ohio 1975), *cert. denied,* 429 U.S. 1074 (1977); *Kramer v. Loewi & Co., Inc.,* 357 F. Supp. 83 (E.D. Wis. 1973); *overruled on other grounds,* 454 F. Supp. 899, 911 n. 4 (E.D. Wis. 1978); *Corey v. Bache & Co., Inc.,* 355 F. Supp. 1123 (S.D. W. Va. 1973).

> equitable doctrine relating to concealment of a "fraud" will apply (even though they have just stated that a Rule 10b-5 violation is not necessarily "fraud" as the reason for applying the Blue Sky statute.)

R. JENNINGS & H. MARSH, SECURITIES REGULATION 859 (4th ed. 1977).

Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), *cert. denied,* 400 U.S. 852 (1970), was the first court to apply the Blue Sky limitations period rather than the common law fraud period. Its reasoning was based on the fact that rule 10b-5 and the Arkansas Blue Sky law were both specifically aimed at securities fraud and shared a "commonality of purpose" making the application of a "resemblance test" a more reasonable ground for choosing the securities-related statute of limitations.[6]

The *Vanderboom* court distinguished the Sixth Circuit's ruling in *Charney v. Thomas,* 372 F.2d 97 (6th Cir. 1967), which had held that neither the Michigan Blue Sky law nor the common law fraud statute were closely analogous to Rule 10b-5. Nevertheless the *Charney* court continued to apply the common law fraud limitation.

Vanderboom distinguished *Charney* in light of the fact that the Sixth Circuit required scienter for a 10b-5 action whereas the Eighth Circuit permitted 10b-5 recoveries where there had been negligent as well as intentional misrepresentation. Since scienter was absent from the Michigan Blue Sky law, application of the common law fraud limitations was the best means of effectuating federal policy. *See* Note, *A Cry for Help: The Ninth Circuit and the Statute of Limitations in Rule 10b-5 Actions,* 22 UCLA L. REV. 947, 954-55 (1975).

[6] *See, e.g., Forrestal Village, Inc. v. Graham,* 551 F.2d 411 (D.C. Cir. 1977); *Fox v. Kane-Miller Corp.,* 542 F.2d 915 (4th Cir. 1976); *Newman v. Prior,* 518 F.2d 97, 100 (4th Cir. 1975) (federal policy best served by applying state blue sky law's two-year statute of limitations to suit involving fraudulent sale of securities); *Sasso v. Koehler,* 445 F. Supp. 762 (D. Md. 1978); *Maine v. Leonard,* 365 F. Supp. 1277 (W.D. Va. 1973).

Although the Supreme Court has recently held that scienter is required for implied causes of action pursuant to Rule 10b-5, *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, *reh. denied,* 425 U.S. 986 (1976), this new requirement would not undermine the validity of *Vanderboom's* resemblance test. Although scienter is now required as an element of a 10b-5 offense, it is only partially relevant to picking the appropriate limitations period. The presence or absence of negligence as a permissible element in an offense seems unrelated to the limitations question in a situation where there is a State statute clearly resembling the federal policy and containing a limitation's period which, on the basis of this resemblance, is thereby more compelling.

Plaintiffs read *Ernst* as mandating application of the state common law fraud limitation:

> The plaintiffs believe that the *Ernst* case is crucial because it converted § 10(b) from a negligence-and-fraud statute into a fraud statute only. As plaintiffs will seek to demonstrate, § 11-703 of the state securities act is a negligence-and-fraud statute—not a fraud statute only. Thus, the state analog to Rule 10b-5, after *Ernst,* is common law fraud, not § 11-703.

Plaintiffs' Memorandum in Opposition to Defendants' Motions to Dismiss and Motions for Judgment on the Pleadings at 9.

In light of what has been said thus far, plaintiffs' argument is unconvincing. Plaintiffs extrapolate too much from *Ernst* which mentioned the statute of limitations issue only in passing. 425 U.S. at 210, n.29. *Holmberg* is still good law, and the goal which it prescribes is fashioning a limitations based on State law which shall blend with "the interstices of the federal enactments" on which the cause of action is based. Even if one conceded plaintiffs' argument that section 11-703(f) was a negligence-and-fraud statute, this Court would have to be literally blind to overlook the substantial similarities between those provisions and Rule 10b-5. Accordingly,

Ernst does not preclude this Court from continued reliance on the limitations period of section 11-703(f) as the appropriate limitations period in this 10b-5 action.[7]

Having concluded this, it is necessary to determine whether, and to what extent, the federal equitable tolling doctrine should be applied in this case. As one court has explained,

> the statute of limitations in a § 10(b) action may be tolled by the "equitable doctrine" of fraudulent concealment. In order to invoke this doctrine, however, the plaintiff must have remained ignorant of the fraud "without any fault or want of diligence or care on his part." Bailey v. Glover, 88 U.S. (21 Wall) 342, 348 (1871). It is well established that a plaintiff may not merely rely on his own unawareness of the facts or law to toll the statute. * * * The plaintiff, rather, has the burden of showing that he "exercised reason-

[7] This result obviously imposes a shorter limitations period, absent any equitable tolling, than would apply in the case of common law fraud. But as one authority has noted, "[s]hort statutes of limitations with an outside cut-off date are particularly appropriate in the case of securities or other fungibles of fluctuating value." Martin, *Statutes of Limitation in 10b-5 Actions: Which State Statute is Applicable?* 29 BUS. LAW. 443 (1974). Although writing prior to the Supreme Court's *Ernst* decision, Martin notes that the presence or absence of scienter is essentially irrelevant to the nature of the limitations question:

> Despite differing approaches among the courts to such questions as *scienter* and reliance, it is universally true that in order to establish the civil liability which has been implied under section 10(b) and rule 10b-5, it is not necessary to allege and prove the classic elements of common law fraud. All such statutes are therefore extraordinary in their scope and do not require the lengthy periods of limitations applicable to common law fraud to effectuate their purposes.

Id. at 457. *See also Newman v. Prior*, 518 F.2d 97, 100 n.4 (4th Cir. 1975). Martin's conclusions have been reinforced by two post-*Ernst* cases. *See, e.g., Forrestal Village, Inc. v. Graham*. 551 F.2d 411, 414 (D.C. Cir. 1977) (similarities outweigh differences); *Dupuy v. Dupuy*, 551 F.2d 1005, 1024 n.31 (5th Cir.), *reh. denied*, 554 F.2d 1065 (5th Cir. 1977) (Blue Sky laws still closer to 10b-5).

> able care and diligence in seeking to learn the facts which would disclose fraud." * * * The statutory period "[does] not wait appellant's leisurely discovery of the full details of the alleged scheme."

Hupp v. Gray, 500 F.2d 993, 996 (7th Cir. 1974) (footnotes omitted). *See also Schaefer v. First National Bank of Lincolnwood,* 509 F.2d 1287, 1295-98 (7th Cir. 1975), *cert. denied,* 425 U.S. 943 (1976); *Hochfelder v. Midwest Stock Exchange,* 503 F.2d 364 (7th Cir.), *cert. denied,* 419 U.S. 875 (1974).[8]

Although the period of limitations will be borrowed from state law whenever equitable tolling is applied, the question of when that limitations period begins is a matter of federal law. *Batchelor v. Legg & Co.,* 52 F.R.D. 553, 558 (D. Md. 1971). As *Holmberg* stated emphatically:

> This equitable doctrine is read into every federal statute of limitation. . . . It would be too incongruous to confine a federal right within the bare terms of a State statute of limitation unrelieved by the settled

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[8] One commentator has traced the origins of the federal equitable tolling doctrine:

> Federal law has long held that where fraud is involved in an action, at law or in equity, the federal statute of limitations is tolled. . . . *Holmberg v. Armbecht* extended this doctrine to toll state statutes of limitations in equitable actions. *Moviecolor [Ltd. v. Eastman Kodak Co.,* 288 F.2d 80 (2d Cir.), *cert. denied,* 368 U.S. 821 (1961)] further extended the concept to apply to state statutes of limitations where the cause of action is federally created and cognizable only in federal courts whether the action was at law or in equity. Consequently, more courts are applying the federal tolling doctrine to 10b-5 actions. This, along with the adoption of the state statute of limitations has resulted in inconsistent periods of limitations for 10b-5 actions among the circuits.

Bateman & Keith, *Statutes of Limitations Applicable to Private Actions Under SEC Rule 10b-5: Complexity in Need of Reform,* 39 MO. L. REV. 165, 177 (1974). *See also* A. BROMBERG, SECURITIES LAW FRAUD — SEC RULE 10b-5 § 8.4 (653) (1975). The introduction of the federal equitable tolling doctrine has been criticized in Note, 22 UCLA L. REV., *supra,* at 961-62.

> federal equitable doctrine as to fraud, when even a federal statute in the same terms would be given the mitigating construction required by that doctrine.

327 U.S. at 397. The accrual date, therefore, is governed by federal law, and limitations will begin to run "on the date that the illegal action is or should have been discovered." 52 F.R.D. at 558.[9]

In the present case, plaintiffs have acknowledged that they first learned of the alleged fraud on November 24, 1975, the date on which the defendants were indicted by the federal grand jury. In such circumstances, the cause of action may be deemed to have accrued no later than this date. Although the sale of stock occurred in 1971, application of the equitable tolling doctrine in this case of an alleged fraud means that the statute of limitations was tolled until November 24, 1975.

Were a three-year fraud limitations to apply, plaintiffs would have had until November 24, 1978 to file this lawsuit. The case was actually filed on November 22, 1978. Yet plaintiffs contend for the first time in their Memorandum opposing dismissal and judgment on the pleadings that regardless of whether state or federal law controls the limitations period, limitations could not begin to run until such time as Josephine O'Hara learned or should have learned of the fraud. Pointing out that Mrs. O'Hara was totally mentally incompetent[10] on November 24, 1975 and has remained so ever since, plaintiffs aver

[9] *See also Sargeant v. Genesco, Inc.*, 492 F.2d 750 (5th Cir. 1974); *Maine v. Leonard*, 365 F. Supp. 1277 (W.D. Va. 1973); *Kramer v. Loewi*, 357 F. Supp. 83 (E.D. Wis. 1973), *overruled on other grounds*, 454 F. Supp. 899, 911 n.4 (E.D. Wis. 1978); *Sieffer v. Topsy's Intern., Inc.*, 64 F.R.D. 714 (D. Kan. 1974), *appeal dismissed*, 520 F.2d 795 (10th Cir. 1975), *cert. denied*, 423 U.S. 1051 (1976).

[10] Plaintiffs point out that on November 24, 1975, Josephine M. O'Hara was totally mentally incompetent and that her disability is irreversible and permanent. Her two sons, Michael and James, were appointed guardians of her property by an equity court in November, 1976.

that the limitations period has not and never will run against her.

Plaintiffs' argument on this point, however, is totally at odds with settled federal case law. "It is a matter of federal law as to the circumstances that will toll a state statute applied to private actions under the securities law." *deHass v. Empire Petroleum Company,* 435 F.2d 1223, 1226 (10th Cir. 1970), *quoting Esplin v. Hirschi,* 402 F.2d 94, 103 (10th Cir. 1968) *cert. denied,* 394 U.S. 928 (1969). As defendants have properly explained, federal law does not allow limitations periods to be tolled by mental incompetence. "Insanity does not prevent a federal statute of limitations from running." *Accardi v. United States,* 435 F.2d 1239, 1241 n.2 (3d Cir. 1970).[11] Plaintiffs have cited no federal authority to the contrary. Although they have attempted to base their tolling argument on state statutory analysis, MD. CTS. & JUD. PROC. CODE ANN. §§ 5-201(a) and 5-203, these provisions are applicable to the general statute of limitations only and not to the limitations applicable in this 10b-5 action. To accept plaintiffs' argument would mean that both the period of limitations and its commencement date would be matters of state law in direct contravention of *deHass, supra.* Accordingly, the Court rejects plaintiffs' arguments that a three-year limitations is applicable and that such limitations have not run due to Josephine O'Hara's continuing mental incompetency. Count I shall therefore be dismissed.

Having dismissed plaintiffs' federal claims at this stage, the Court must also decline to hear their state claims since grounds for maintaining pendent jurisdiction are now lacking. "Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well." *United Mine Workers v. Gibbs,* 383 U.S. 715, 726 (1966).

[11] *See also Casias v. United States,* 532 F.2d 1339 (10th Cir. 1976); *Williams v. United States,* 228 F.2d 129, 132 (4th Cir. 1955); *Jackson v. United States,* 234 F. Supp. 586, 587 (E.D. S.C. 1964); *Kalil v. United States,* 107 F. Supp. 966 (E.D. N.Y. 1952).

See also Shuman v. Sherman, 356 F. Supp. 911 (D. Md. 1973).

Defendants Kovens and Williams A. Rodgers have adopted the arguments advanced by defendants Mandel, et al. in support of their motion for judgment on the pleadings. As a result, all counts shall also be dismissed as against these defendants as well as defendant Casey.

Accordingly, it is this 12th day of july, 1979, by the United States District Court for the District of Maryland, ORDERED: that plaintiffs' complaint be, and the same is, hereby DISMISSED.

Joseph H. Young,
United States District Judge

United States Court of Appeals
For The Fourth Circuit

No. 79-1524

James Francis O'Hara, III, Michael Patrick O'Hara, individually and as guardians of the property of Josephine M. O'Hara,

Appellants,

versus

Irvin Kovens, Marvin Mandel, W. Dale Hess, Harry W. Rodgers, III, William A. Rodgers, Ernest N. Cory, Jr., Eugene B. Casey, Irving T. Schwartz,

Appellees.

Appeal from the United States District Court for the District of Maryland, at Baltimore. Joseph H. Young, District Judge

---

Argued May 5, 1980 *Decided July 16, 1980*

Before HAYNSWORTH, Chief Judge, BUTZNER and PHILLIPS, *Circuit Judges*

James B. Wieland, William A. Snyder, Jr. (John T. Ward, Ober, Grimes & Shriver on brief) for Appellants; Gerrard Martin (Arnold M. Weiner; William F. Gately; William G. Hundley; Thomas C. Green; Gary M. Anderson; Charles W. Bills; H. Russell Smouse on Brief) for Appellees.

HAYNSWORTH, *Chief Judge:*

Presented on this appeal is the civil counterpart to *United States v. Mandel,* 602 F.2d 653 (4th Cir.) (en banc), *modifying and rev'g,* 591 F.2d 1347 (4th Cir. 1979). Plaintiffs claim to be defrauded sellers of stock in the Marlboro Race Track. Suit is brought under the Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (b), and rule 10b-5, 17 C.F.R. § 240.10b-5. Also charged is a violation of Maryland's blue sky law, Md. Corps. & Ass'ns Code Ann. § 11-703 (a)(2) (Supp. 1979), as well as common law fraud. The defendants, with two additions, are the same individuals who were indicted in the criminal proceeding.

The district court held that the bar of statute of limitations required dismissal of the § 10(b) claims. Since the federal claims were dismissed prior to trial, the pendent state claims were dismissed as well. *See United Mine Workers v. Gibbs,* 383 U.S. 715, 726 (1966). Plaintiffs contend that the district court relied upon the wrong statute of limitations and that, in any event, the incompetency of one of the plaintiffs tolled the running of the statute.

We affirm for reasons slightly different from those stated in the district court opinion. *O'Hara v. Kovens,* 473 F. Supp. 1161 (D. Md. 1979).

I.

Since a private right of action under § 10(b) is implied, the timeliness of a suit filed under that section is determined by reference to the forum state's law of limitations. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 210 n.29 (1976); *Holmberg v. Armbrecht,* 327 U.S. 392, 395 (1946). Private actions under Maryland's blue sky law must be commenced within one year of a reasonable date of discovery. Md. Corp. & Ass'ns Code Ann. § 11-703(f). The district court relied upon this statute in dismissing the suit. The plaintiffs contend that the court should have looked to Maryland's three year statute of limitations

which is applicable to civil actions without specified time limitations and, as a consequence, applicable to common law fraud. Md. Cts. & Jud. Proc. § 5-101. Under this section, suit would have been timely filed.[1]

The thrust of plaintiffs' argument is that this sellers' suit is more closely analogous to common law fraud than it is to any cause of action which was available under Maryland's blue sky law as of the date this cause of action accrued. Two differences between the state's blue sky law and the federal scheme are suggested. First, there appears to be no requirement of scienter under Maryland's blue sky statute, while *Ernst & Ernst, supra,* has established scienter as a requirement in private actions under § 10(b) and rule 10b-5. We agree with the district court that this distinction does not warrant an adoption of the common law fraud statute of limitations. 473 F. Supp. at 1165. The federal and state securities laws both promote the same policy of full disclosure in stock transactions. This commonality of purpose overrides lesser distinctions which may arise in the implementation of the regulatory schemes. *Morris v. Stifel, Nicolaus & Co., Inc.,* 600 F.2d 139, 142-46 (8th Cir. 1979); *Dupuy v. Dupuy,* 551 F.2d 1005, 1023-24 n.31 (5th Cir. 1977); *see also Fox v. Kane-Miller Corp.,* 542 F.2d 915, 918 (4th Cir. 1976); *Newman v. Prior,* 518 F.2d 97, 100 (4th Cir. 195); *Vanderboom v. Sexton,* 422 F.2d 1233, 1236-41 (8th Cir. 1970). Second, plaintiffs note that prior to July 1, 1976, Maryland's blue sky law did not prive a civil remedy for defrauded sellers. *See Goodman v. Poland,* 395 F. Supp. 660 (D. Md. 1975). Thus, when this cause of action accrued, under state law, a defrauded seller of securities could proceed with a private action only for common law fraud. Plaintiffs argue that this lack of a securities fraud private remedy under state law, precludes application of the blue sky statute of limitations to plaintiffs' § 10(b) claims. We do not agree.

[1] The district court assumed that this cause of action had accrued on November 24, 1975, the date upon which the *Mandel* indictments issued. Suit was filed on November 22, 1978.

Although Maryland's blue sky law did not establish a private remedy for defrauded sellers until after July 1, 1976, the blue sky law did proscribe the specific behavior challenged in this suit under § 10(b) and rule 10b-5. It provided criminal sanctions to support a seller's right. Md. Corps. & Ass'ns Code Ann. §§ 11-301, 11-417.[2] We think this latter factor is more significant, for present purposes, than is Maryland's former lack of a seller's private right of action. The fact that one statutory scheme permits a seller to sue, while the other does not, in no way undermines the simple truth that the federal and state statutes at issue here were designed to achieve similar ends. Both were designed to protect the securities market from manipulative and deceptive practices by buyers and sellers.

When borrowing a state statute of limitations for federal purposes, a court should look to the statute which most clearly addresses the same or similar policy considerations as are addressed by the federal right being asserted. It is not necessary that the state statute operate in the same fashion as the federal scheme, nor is it necessary that the state statute describe a cause of action identical to the federal cause at issue. *Morris v. Stifel, Nicolaus & Co., Inc., supra,* 600 F.2d at 142-146; *Dupuy v. Dupuy, supra,* 551 F.2d at 1023-24 n.31. There simply must be a commonality of purpose between the federal right and the state statutory scheme so that it is reasonable to subject the federal implied right to the statute of limitations provided by state law. By comparison, the shared purposes

[2] Section 11-301 provides:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly to:
>
> (1) Employ any device, scheme, or artifice to defraud;
>
> (2) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
>
> (3) Engage in any act, private, or course of business which operates or would operate as a fraud or deceit on any person.

between § 10(b) and common law fraud are generalized at best. In *Fox v. Kane-Miller Corp.*, 542 F.2d 915, 918 (4th Cir. 1976), we held that the statute of limitations found in Maryland's blue sky law, Md. Corp. & Ass'ns Code Ann. § 11-703(f), would be applicable to implied actions arising under § 10(b). We see no reason to stray from that holding.[3]

II.

Plaintiffs further claim that the running of the statute of limitations should have been tolled by the incompetency of one of the plaintiffs.[4] In *Johnson v. Railway Express Agency,* 421 U.S. 454 (1975), the Court stated

> Any period of limitation . . . is understood fully only in the context of the various circumstances that suspend it from running against a particular cause of action. Although any statute of limitations is necessarily arbitrary, the length of the period allowed for instituting suit inevitably reflects a value judgment concerning the point at which the interest in favor of protecting valid claims are outweighed by the interests in prohibiting the prosecution of stale ones. In virtually all statutes of limitations the chronological length of the limitation period is interrelated with provisions regarding tolling, revival, and questions of application. In borrowing a state period of limitation for application to a federal cause of action, a federal

[3] In *Roberts v. Magnetic Metals Co.,* 611 F.2d 450 (3d Cir. 1979), a split panel of the Third Circuit found that in a seller's suit, the lack of a seller's remedy under state law required the court to rely upon a common law fraud statute of limitations. However, the state securities law at issue in *Roberts* provided "no protection to sellers or tenderers of securities." *Id.* at 453. As discussed in the text, Maryland's securities law did provide protection for sellers. Thus, the problem faced in *Roberts* is not presented here, *i.e.,* whether a court should apply a blue sky statute of limitations when the blue sky law does not regulate the behavior being challenged. *See also McNeal v. Paine, Weber, Jackson & Curtis,* 598 F.2d 888 (5th Cir. 1979).

[4] Josephine O'Hara was incompetent when this cause of action accrued. However, her sons, also named plaintiffs, have been her guardians since November of 1976.

> court is relying on the State's wisdom in setting a limit, and exceptions thereto, on the prosecution of a closely analogous claim.

Id. at 453-64. Under this reasoning we must apply the tolling provisions provided by Maryland law. *See also Board of Regents v. Tomanio*, ___ U.S. ___, 48 U.S.L.W. 4556, 4558-59 (May 20, 1980). Section 11-703(f) makes no provision for tolling on grounds of incompetency. We are not empowered to engraft such a provision onto the Maryland Code, and the facts of this case do not warrant an application of federal equitable relief. *See* Tomanio, *supra*, ___ U.S. at ___, 48 U.S.L.W. at 4559-60; Johnson, *supra*, 421 U.S. at 465.

Affirmed.

Securities Exchange Act of 1934, § 10
15 U.S.C. § 78

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Commission Rule 10b-5
17 C.F.R. § 240.10b-5

Employment of manipulative and deceptive devices

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Maryland Securities Act Md. Code Ann., Corp. and Assoc. Art. § 11-703

(as enacted Ann. Code of Md. 1957, art. 32A, § 34; 1975, ch 311, § 2)

Civil liabilities.

(a) *When seller is liable.* — A person is civilly liable to the person buying a security from him if he:

(1) Offers or sells the security in violation of §§ 11-304(b), 11-401, or 11-501 of this title, or of any rule or order under § 11-205 of this title which requires the affirmative approval of sales literature before it is used; or

(2) Offers or sells the security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made not misleading, the buyer not knowing of the untruth or omission, and if he does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

(b) *Extent of liability.* — (1) A buyer may sue either at law or in equity:

(i) On tender of the security, to recover the consideration paid for the security, together with interest at 6 percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security; or

(ii) If he no longer owns the security, for damages.

(2) Damages are the amount that would be recoverable on a tender less the value of the security when the buyer disposed of it and interest at 6 percent per year from the date of disposition.

(c) *Others jointly and severally liable with seller.* — (1) Every person who directly or indirectly controls a seller liable under subsection (a) of this section, every partner, officer, or director of the seller, every person occupying a similar status or performing similar functions, every employee of the seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

(2) There is contribution as in cases of contract among the several persons so liable.

(d) *Time of making tender.* — Any tender specified in this section may be made at any time before entry of judgment.

(e) *Survival of cause of action.* — Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

(f) *Limitation of actions; effect of offer of refund.* — (1) Except as provided in paragraph (2) of this subsection, a person may not sue under this section more than three years after the contract of sale.

(2) An action may not be maintained:

(i) To enforce any liability created under subsection (a) (1) of this section, unless brought within one year after the violation on which it is based; or

(ii) To enforce any liability created under subsection (a)(2) of this section, unless brought within one year after the discovery of the untrue statement or omission, or after the discovery should have been made by the exercise of reasonable diligence.

(3) A person may not sue under this section:

(i) If the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at 6 percent per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within 30 days of its receipt; or

(ii) If the buyer received the offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within 30 days of its receipt.

(g) *Effect of making or performing contract with knowledge of facts.* — A person may not base any suit on any contract if he:

(1) Has made or engaged in the performance of the contract in violation of any provision of this title or any rule or order under this title: or

(2) Has acquired any purported right under the contract with knowledge of the facts by reason of which its making or performance was in violation.

(h) *Provision for waiver of compliance with section void.* — Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or any rule or order under this title is void.

(i) *Rights and remedies additional to others.* — The rights and remedies provided by this title are in addition to any other rights or remedies that may exist at law or in equity, but this title does not create any cause of action not specified in this section or § 11-410 of this title.

(as amended Ann. Code of Md. 1976, Ch. 615 § 1)

Civil liabilities.

(a) *When seller or purchaser is liable.* — (1) A person is civilly liable to the person buying a security from him if he:

(i) Offers or sells the security in violation of §§ 11-304 (b), 11-401, or 11-501 of this title, or of any rule or order under § 11-205 of this title which requires the affirmative approval of sales literature before it is used; or

(ii) Offers or sells the security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and if he does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

(2) A person is civilly liable to the person selling a security to him if he:

(i) Offers to purchase or purchases the security in violation of §§ 11-902, 11-903, 11-904, or 11-905 of this title, or

(ii) Offers to purchase or purchases the security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, the seller not knowing of the untruth or omission, and if he does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

(b) *Extent of liability.* — (1) A buyer may sue either at law or in equity:

(i) On tender of the security, to recover the consideration paid for the security, together with interest at 6 percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security; or

(ii) If he no longer owns the security, for damages.

(2) A seller may sue either at law or in equity:

(i) On tender of the consideration paid for the security, to recover the security, together with the amount of any income received on the security, costs, and reasonable attorneys' fees; or

(ii) If the buyer no longer owns the security, for damages.

(3) For the purposes of subsection (b) (1) (ii) of this section, damages are the amount that would be recoverable on a tender less the value of the security when the buyer disposed of it and interest at 6 percent per year from the date of disposition.

(c) *Others jointly and severally liable with seller or purchaser.* — (1) Every person who directly or indirectly controls a person liable under subsection (a) of this section, every partner, officer, or director of the person liable, every person occupying a similar status or performing similar functions, every employee of the person liable who materially aids in the sale or purchase, and every broker-dealer or agent who materially aids in the sale or purchase are also liable jointly and severally with and to the same extent as the person liable, unless the nonseller or nonbuyer who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

(2) There is contribution as in cases of contract among the several persons so liable.

(f) *Limitation of actions; effect of offer of refund.* — (1) A person may not sue under this section after the earlier to occur of three years after the contract of sale or purchase or the time specified in paragraph (2) of this subsection.

(2) An action may not be maintained:

(1) To enforce any liability created under subsections (a) (1) (i) or (a) (2) (i) of this section, unless brought within one year after the violation on which it is based; or

(ii) To enforce any liability created under subsections (a) (1) (ii) or (a) (2) (ii) of this section, unless brought within one year after the discovery of the untrue statement or omission, or after the discovery should have been made by the exercise of reasonable diligence.

(3) A person may not sue under this section:

(i) If the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at 6 percent per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within 30 days of its receipt;

(ii) If the buyer received the offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within 30 days of its receipt; or

(iii) If the seller received a written offer from the buyer, before suit, to return the security, together with the amount of any income received on the security, less interest at 6 percent per year from the date of payment, and he failed to accept the offer within 30 days of its receipt.

(i) *Rights and remedies additional to others.* — The rights and remedies provided by this title are in addition to any other rights or remedies that may exist at law or in equity, but this title does not create any cause of action

not specified in this section or §§ 11-410 or 11-906 of this title.

Maryland Code Annotated

COURTS AND JUDICIAL PROCEEDINGS

TITLE 5.

LIMITATIONS AND PROHIBITED ACTIONS.

Subtitle 1. Limitations.

§ 5-101. Three-year limitation in general.

A civil action at law shall be filed within three years from the date it accrues unless another provision of the Code provides a different period of time within which an action shall be commenced.

Subtitle 2. Computing Time.

§ 5-201. Persons under a disability.

(a) *Extension of time.* — When a cause of action subject to a limitation under Subtitle 1 accrues in favor of a minor or mental incompetent, that person shall file his action within the lesser of three years or the applicable period of limitations after the date the disability is removed.

(b) *Exception.* — This section does not apply if the statute of limitations has more than three years to run when the disability is removed.

(c) *Disabilities abolished.* — Imprisonment, absence from the State, or marriage are not disabilities which extend the statute of limitations.

§ 5-203. Ignorance of cause of action induced by fraud.

If a party is kept in ignorance of a cause of action by the fraud of an adverse party, the cause of action shall be deemed to accrue at the time when the party discovered, or by the exercise of ordinary diligence should have discovered the fraud.

No. 80-580

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JAMES FRANCIS O'HARA, III, MICHAEL PATRICKS O'HARA, INDIVIDUALLY AND AS GUARDIANS OF THE PROPERTY OF JOSEPHINE M. O'HARA,

Petitioners,

v.

IRVIN KOVENS, MARVIN MANDEL, W. DALE HESS, EARNEST N. CORY, JR., EUGENE B. CASEY, IRVING T. SCHWARTZ,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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No. 80-580

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Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

The Respondents, Irvin Kovens, Marvin Mandel, W. Dale Hess, Ernest N. Cory, Jr., Eugene B. Casey, and Irving T. Schwartz, respectfully request that this Court deny the petition for writ of certiorari, seeking review of the judgment of the United States Court of Appeals for the Fourth Circuit, in this case. The opinion of the Court of Appeals for the Fourth Circuit is reported at 625 F.2d 15 (4th Cir. 1980).

STATEMENT OF THE CASE

The Petitioners are James Francis O'Hara and Michael Patrick O'Hara, individually and as guardians of the

property of their mother, Josephine M. O'Hara. Their petition seeks to review the Fourth Circuit's affirmation of an order entered in the United States District Court for the District of Maryland, by Judge Joseph H. Young, dismissing a private action for alleged securities fraud.

The O'Haras are three of the former stockholders of Marlboro Racetrack. Their action, filed on November 22, 1978, sought damages for fraud allegedly practiced upon them in connection with the December, 1971 sale of their stock. James and Michael, who had been guardians of Josephine's property for two years, since November 22, 1976, claimed that they discovered the alleged fraud on November 25, 1975, almost three years before instituting suit.

The complaint was in three counts. The first count, founded on a federal cause of action, alleged that the conduct of the defendants was in violation of Section 10(b) of the Securities Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The second count asserted that the defendants' actions amounted to a "violation of the Maryland Securities Act," and the third count alleged that they constituted "common law fraud". Jurisdiction of the second and third counts, based entirely on State causes of action, was claimed "under the doctrine of pendent jurisdiction".

Simultaneously with the filing of the federal action, the O'Haras filed suit in the Superior Court of Baltimore City. The declaration in the State case contains two counts which are identical to the second and third counts of the complaint in the federal action. By agreement of counsel, further proceedings in the State case were stayed until the resolution of the present case. Since the federal complaint was dismissed, the plaintiffs have been free to proceed with their case in the State court.

The complaint alleged that the defendants initiated a fraudulent scheme "at some point, between January 7, 1969 and May 28, 1971;" that, in 1971, they secretly and deceptively acted to depress the value of the plaintiffs' stock; that the plaintiffs "sold their stock on or about December 31, 1971;" and that, in 1972, after purchasing "the controlling interest in Marlboro," the defendants acted, partly in secret, to increase the value of the stock "theretofore fraudulently acquired from the plaintiffs." It was also alleged that the plaintiffs "began learning and discovering" the alleged fraud on November 24, 1975, almost three years before this action was filed, when the defendants were indicted "by the federal grand jury" in the District of Maryland.

On July 16, 1979, the District Judge granted motions for dismissal and for judgment on the pleadings. In a written opinion, he held that the federal claim under Section 10(b) and Rule 10b-5 was subject to the one-year limitations period of the Maryland blue sky law, and, that the action, not brought until nearly three years after the discovery of the alleged fraud, therefore was barred (by limitations.) 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. The state claims, asserted only by way of pendent jurisdiction, were dismissed as well. *See, O'Hara v. Kovens,* 473 F. Supp. 1161 (D. Md. 1979), (Pet. App. 1a).

Following oral argument, the United States Court of Appeals for the Fourth Circuit affirmed the dismissal. *See O'Hara v. Kovens,* 625 F.2d 15 (4th Cir. 1980) (Pet. App. 13a)

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I.

REVIEW IS UNNECESSARY SINCE THERE ALREADY EXIST UNIFORM GUIDELINES FOR FIXING A PERIOD OF LIMITATIONS FOR IMPLIED CAUSES OF ACTION ARISING UNDER THE FEDERAL SECURITY STATUTES.

The Petitioners' federal claims are based on the implied right of action arising under Section 10(b) of the Securities & Exchange Act of 1934. *See, Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975).

Although the Securities & Exchange Act of 1934 contains express limitations periods for causes arising under various sections thereunder, it is settled law, not challenged by Petitioners, that these express limitation provisions do not govern the right of action implied under Section 10(b) of the Act. *See, Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 210 n. 29 (1976). Similarly, it is also settled law, not challenged by Petitioners, that federal courts must fix, as a matter of federal common law, a period of limitations for suits based on Section 10(b) of the federal securities laws. *Ernst & Ernst, supra.*

Finally, it is a basic rule, equally well settled and not challenged by Petitioners, that a federal court must apply the period which the forum State applies to a State cause of action bearing the closest substantive resemblance to the implied cause of action arising under the federal securities laws. *Id.* Every circuit has adopted and applies this rule. *See, e.g., Vanderboom v. Sexton,* 422 F.2d 1233 (8th Cir. 1970); *Mitchell v. Texas Gulf Sulphur Co.,* 446 F.2d 90 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971), *reh. denied,* 404 U.S. 1064 (1972); *Parrent v. Midwest Rug Mills, Inc.,* 455 F.2d 123 (7th Cir. 1972); *United California Bank v. Salik,* 481 F.2d 1012, (9th Cir. 1973), *cert. denied,* 414 U.S. 1004 (1974); *Nickels v. Koehler Management*

Corp., 541 F.2d 611 (6th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977); *Stull v. Bayard*, 561 F.2d 429 (2nd Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); *Forrestal Village, Inc. v. Graham*, 551 F.2d 411 (D.C. Cir. 1977); *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888 (5th Cir. 1979); *Roberts v. Magnetic Metals Co.*, 611 F.2d 450 (3rd Cir. 1979); *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978).

Despite the universal acceptance of these basic and well settled rules of law, Petitioners suggest that there is a conflict among the circuit courts by reason of "inconsistent interpretations by different federal courts of the same body of federal law". Pet. at 10. To support this proposition, Petitioners misconstrue the cases upon which they rely.

First, Petitioners find evidence of such a conflict among the circuits by quoting Judge McCree's opinion in *Nickels v. Koehler Management Corp., supra,* to the effect that there exists an "anomaly of applying different limitations period to plaintiffs who purchased or sold the same security but resided in different states." *Id* at 614.

It is true the such an "anomoly" exists, but it is inherent in the very nature of the federal "borrowing" rule. Even if every circuit chose the forum State's general fraud statute as the limitations period for Section 10(b) actions, nevertheless the limitations periods applied to cases arising in different states would vary enormously. Thus, residents of Massachusetts would have but two years in which to bring suit, *see, Cook v. Avien, Inc., supra;* while residents of Arkansas, California, District of Columbia and Utah would have three years, *see, Vanderboom v. Sexton, supra* (Ark.), *United California Bank v. Salik, supra* (Cal.); *Forrestal Village, Inc. v. Graham, supra* (D.C.); *Mitchell v. Texas Gulf Sulphur Co., supra* (Utah); and residents of Georgia and Ohio would have four years in which to file suit, *see, McNeal v. Paine, Webber, Jackson & Curtis, Inc.,*

supra (Ga.); *Nickels v. Koehler Management Corp., supra* (Ohio); while residents of Illinois would have five years in which to file suit, *see, Parrent v. Midwest Rug Mills, Inc., supra;* and, finally, residents of New York and New Jersey would have six years in which to file suit, *see, Stull v. Bayard, supra* (N.Y.); and *Roberts v. Magnetic Metals Co., supra* (N.J.). Similarly, even if every circuit chose the forum State's blue sky statute as the appropriate limitations period, the actual periods would encompass periods of one year, *O'Hara v. Kovens, supra* (Md.); or two years, *Vanderboom v. Sexton, supra* (Ark.); or three years, *Parrent v. Midwest Rug Mills, Inc., supra* (Ill.); or four years, *United California Bank v. Salik* (Cal.).

The point is simple. Regardless of the statute of the forum State chosen as a basis for fixing federal limitations in Section 10(b) actions, the limitations period would nevertheless vary from circuit to circuit and from State to State by as much as four years. This variation is endemic in the settled rule that the federal courts must supply a limitations period by borrowing from an analogous period chosen by the forum State. Obviously, since different States have fixed different limitations periods for similar causes of action, the rule necessarily results in different terms of years being applied by federal courts to similar cases. However, this variation among circuits is no evidence of a "conflict" among circuits. Indeed, this variation is evidence of harmony among the circuits since they are all applying the same rule to different local circumstances, which application necessarily yields a difference in result.

The only solution to such differences would be for the Congress to fix and determine a definite period of limitations which would apply to all implied causes of action arising under Section 10(b), regardless of where they are filed. Such a change of governing law, not

requested by Petitioners, would be inappropriate for the Court to undertake.

The sources of the rule requiring resort to State law are early decisions of this Court holding that State statutes of limitations generally govern the timeliness of federal causes of action unless Congress has specifically provided otherwise. *Campbell v. City of Haverhill.* 155 U.S. 610 (1895); *McCluny v. Silliman,* 28 U.S. (3 Pet.) 270 (1830). *See generally,* Hill, *State Procedural Law in Federal Non-Diversity Litigation,* 69 Harv. L. Rev. 66, 79-80 (1955). These early cases recognize that fixing limitations periods for different types of actions is a task uniquely suited to a legislative body. More recently, in a suit upon a collective bargaining contract under Section 301 of the Labor Management Relations Act of 1947, 29 U.S.C. § 185, this Court rejected the claim that it devise a uniform time limitation and instead applied a State statute of limitations, with the comment that "the teaching of our cases does not require so bald a form of judicial innovation." *International Union v. Hoosier Cardinal Corp.,* 383 U.S. 696, 701 (1966). This Court further stated:

> "Thus, although a uniform limitations provision for § 301 suits might well constitute a desireable statutory addition, there is no justification for the drastic sort of judicial legislation that is urged upon us." *Id.* at 702-03.

There have, of course, been proposals for legislation to solve the problem of different time periods applying to Section 10(b) suits, if problem it be. For example, the American Law Institute has proposed a recodification of the federal securities laws which would contain a uniform federal statute of limitations applicable to all claims, expressed and implied, arising under the securities laws. *See,* A.L.I., *Federal Securities Code, proposed official draft,* Section 1727 (March 15, 1978). Congress has yet to adopt the A.L.I. recommendation, and until it does so, especially

in view of the fact that the Petitioners do not urge any different course, this Court ought leave undisturbed the well settled and universally accepted rule of borrowing in Section 10(b) cases.

Even though Petitioners do not seek to have the borrowing rule changed, they suggest that the "difficulties inherent in this choice have plunged the circuits into a morass of inconsistent and irreconcilable decisions". Pet. at 15. Aside from pointing out the different periods of time selected by different circuits in different cases, Petitioners also suggest that there is a conflict among circuits because some circuits have chosen the period of limitations contained in a forum State's blue sky laws while others have chosen some other period of limitations.

Once again, this variation is not a function of any conflict in accepting or applying governing principles of law. It simply reflects the fact that local laws do differ from each other. While one cause of action pursuant to one state's blue sky Law may closely resemble a Section 10(b) cause of action, a cause of action under another state's blue sky Law may be so restricted (or expanded) in coverage as to offer no analogy to Section 10(b). Similarly, one State may have a particular statute of limitations governing a common law fraud action which is closely analogous to a Section 10(b) action while another State may have a common law rule of fraud which is too restrictive (or expanded) to be considered a match.

Ultimately, the choice must be made on a case-by-case basis, by comparison of (1) the particular allegations of the federal complaint, (2) the forum State's blue sky statue, where the State has a blue sky statute, (3) the forum State's common law rules of fraud, (4) the forum State's statute of limitations, if any, specifically applicable to common law fraud, and (5) the forum State's other available statute of limitations. Given these variables, it is

to be expected that actual results will vary from circuit to circuit and even within the same circuit, in cases arising from different states.

For example, Petitioners suggest that the Fifth Circuit's opinion in *McNeal v. Paine, Webber, Jackson & Curtis, Inc., supra,* demonstrates that the Fifth Circuit's borrowing rule is "in a state of flux". Pet. at p. 10. It is true that *McNeal* applies Georgia's "fraud" statute of limitations to a Section 10(b) cause of action, and that the Fifth Circuit had earlier applied Florida's blue sky law to a Rule 10(b)-5 cause of action in *Hudak v. Economic Research Analysts, Inc.,* 499 F.2d 996 (5th Cir. 1974). Because of these different results, Petitioners suggest that the *McNeal* case is inconsistent with *Hudak.*

Hudak and *McNeal* are not inconsistent. They reach different results because the Florida and Georgia statutes differ from one another and because the complaints in both cases also differ. As explained by the Fifth Circuit in *McNeal*:

> "Although the language of Section 11 of the Georgia Securities Act of 1957 mimics that of Rule 10(b)-5 . . . the remedy made available by Section 13 is expressly limited to an action for rescission. . . . Any similarity between the damages remedy available to [the Plaintiff] under section 10(b) and the rescission remedy available under the Georgia Securities Act of 1957 is therefore, at best, uncertain. By contrast, there is no reason to doubt that Georgia's general fraud statute would support an action for money damages based on the churning of [Plaintiff's] account. . . . Hence, we conclude that the cause of action available under the general fraud statute more closely resembles [Plaintiff's] cause of action under section (10b) than that available under the Georgia Securities Act of 1957. . . .
>
> In so holding, we distinguish the prior decision of this court in *Hudak v. Economic Research Analysts,*

> *Inc.* . . . In that case, the plaintiff sought to return the purchase price of worthless securities bought for him by a broker who converted the plaintiff's funds to his own use. The court concluded the cause of action available under the Florida sale of securities law (identical, for practical purposes, to the Georgia Securities Act of 1957) more closely resembled the plaintiff's cause of action under section (10b) than did the cause of action available under the Florida general fraud statute. The court stressed, however, 'the congruence between the specific remedy sought here — return of the purchase money — and the remedy of rescission for which Florida securities law provides a two-year statute.'" (citations omitted)

Id. at 894.

It is clear, therefore, that the Fifth Circuit found the results in both cases to be in harmony with each other, and, in fact, they are. The simple fact of the matter is that the factual allegations of both complaints differed from one another, as did the particular security statutes involved. Hence, one would expect, as was the case, that different results would be reached.

The Petitioners fail to point out that in most of the cases in which a particular circuit chose the forum State's fraud statute of limitations, that particular forum State had a general fraud statute which contained its own statute of limitations.

By contrast, Maryland has no fraud statute nor does it have a special statute of limitations which applies only to fraud actions. The choice in the present case was between the limitations statute in Maryland's blue sky law, which was applied by the courts below, or the three-year catch all provision applicable generally to civil actions at law, Md. Cts. & Jud. Proc. Code Ann., Section 5-101. The catch-all provision, Section 5-101, applies to contracts as well as torts, to actions of negligence as well as those of intention-

al wrong, and even to cases involving liability without fault. As between the two available Maryland statutes the limitations provision of the blue sky law, tailored specially to securities transactions, was a more appropritate choice, whatever might be the case with respect to other states.

In summary, the decision below is clearly correct with respect to its application of Maryland law and it is consistent with the decisions recorded in similar decisions in other circuits.

II.

THE COURTS BELOW PROPERLY HELD THAT THE STATUTE OF LIMITATIONS WAS NOT TOLLED BY REASON OF MRS. O'HARA'S MENTAL INCOMPETENCY.

James and Michael O'Hara have been guardians of Josephine O'Hara's property since November 22, 1976. They claim that they discovered the alleged fraud on November 25, 1975. This suit was instituted on November 22, 1978. The question is whether the courts below were correct in holding that the cause of action accrued not later than November 22, 1976, the date upon which they were appointed as guardians, almost one full year after discovery of the alleged fraud.

The Petitioners suggest that a statute of limitations will never run against a mental incompetent until the disability is removed regardless of whether or not a guardian of the incompetent's property has been appointed. Because the lower courts found no support for such a proposition in either Maryland law or in federal equitable principles, Petitioners seek certiorari in this Court.

Petitioners' position is fundamentally wrong. The Court of Appeals was guided, as Petitioners concede, by *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454 (1975). The Court of Appeals decision was entirely consistent with the

recent case of *Board of Regents v. Tomiano*, ___ U.S. ___, 48 U.S.L.lW. 4556 (May 19, 1980), 100 S. Ct. 1790 (1980). Both *Johnson* and *Tomiano* hold that where State law is borrowed for a limitations period, State law should also furnish the grounds for tolling and other ancillary provisions of limitations, except where inconsistent with the federal policy underlying the cause of action under consideration. As this Court pointed out in *Tomiano*, "a state statute cannot be considered inconsistent with federal law merely because the statute causes the plaintiff to lose the lititgation." *Id.* at 1797.

As the Court of Appeals properly concluded, Maryland's blue sky law makes no provision for tolling on grounds of incompetency. Equally correct is the Court of Appeals' decision that there are no federal equitable grounds for engrafting such a provision onto the Maryland Code. Indeed, federal law does not allow limitations periods to be tolled by mental incompetency. *Accardi v. United States*, 435 F.2d 1239, 1241 n.2 (3d Cir. 1970); *Casias v. United States*, 532 F.2d 1339 (10th Cir. 1976); *Williams v. United States*, 228 F.2d 129, 132 (4th Cir. 1955).

Not only is the result below consistent with Maryland law and with well accepted federal law, but it is also consistent with the policies underlying the federal securities statutes. It would be incongruous in the extreme to grant a plaintiff a perpetual cause of action for securities fraud. Where no limitations period is included in a federal statute "both state and federal courts have applied the state law of limitations, in the belief that Congress would not have intended the anomaly of a class of perpetual rights." *Developments in the Law — Statutes of Limitations*, 63 Harv. L. Rev. 1177, 1266 (1950). Since the underlying purpose of the securities acts is to facilitate reliability in the capital formation markets of the United States, it would hardly serve that purpose by excluding,

forever, the period of time in which the guardians of incompetents may "sit on their rights" before filing suit.

III.

THE DECISIONS BELOW WERE CONSISTENT WITH THIS COURT'S DECISION IN *ERNST & ERNST V. HOCHFELDER*.

The Court in *Ernst & Ernst, supra,* held that Section 10(b) incorporates a requirement that scienter be proven before liability in a private cause of action may be imposed. In so holding, this Court made reference to, and approved, the principle of "borrowing" an anlogous State court period of limitations to be applied in a Section 10(b) action in federal court. 425 U.S. at 210, n. 29. Despite Petitioners' contentions to the contrary, the Court did not suggest that the borrowing concept was improper in *Ernst & Ernst* nor did it express any disagreement therewith.

The suggestion, therefore, that *Ernst & Ernst* "justifies" an out-of-hand rejection of a one-year limitations period as being too short to impose upon a cause of action under Section 10(b) is simply without support.

CONCLUSION

For these reasons, Respondents respectfully request that the Petition for Certiorari be denied.

Respectfully submitted,

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